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**Committee of Experts on International Cooperation in Tax Matters**
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Item 3 (i) of the provisional agenda*
**Discussion of substantive issues related to international cooperation in tax matters: article 14 of the United Nations Model Convention**

## Issues relating to article 14 of the United Nations Model Convention

### Note by the Secretariat

1. The annexed note has been prepared by Professor Brian Arnold at the request of the Secretariat, acting on behalf of the Subcommittee on Article 14 of the United Nations Model Convention. The Subcommittee was mandated[1] by the Committee of Experts on International Cooperation in Tax Matters at its fifth annual session, in 2009, as follows:

> "The Subcommittee is mandated to propose updates and improvements to article 14, especially for those countries that would like to maintain this article. In particular, the problems with regard to scope, coverage and diverging interpretations should be addressed either by a new text for article 14, providing different options for solutions, or by drafting in the commentaries. The Subcommittee will present its conclusions at the next annual session."

2. The views expressed in the annexed note should not be taken as necessarily representing the views of the United Nations.

* E/C.18/2010/1.

[1] See E/2009/45-E/C.18/2009/6, paras. 9 and 10.

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# Annex

## Possible revisions to article 14 of the United Nations Model Convention

## I. Introduction

1. The present note has been prepared[a] for the Subcommittee on Article 14 of the United Nations Model Convention, as mandated by the Committee of Experts on International Cooperation in Tax Matters at its Fifth Session, in the report on the session (E/2009/45-E/C.18/2009/6), held in Geneva from 19 to 23 October 2009. The mandate of the Subcommittee is as follows:

> "The Subcommittee is mandated to propose updates and improvements to article 14 especially for those countries that would like to maintain this article. In particular, the problems with regard to scope, coverage and diverging interpretations should be addressed either by a new text for article 14, providing different options for solutions, or by drafting in the commentaries. The Subcommittee will present its conclusions at the next annual session."

2. At its fifth session, the Committee of Experts approved changing the wording of article 5 (3) to refer to 183 days, rather than to six months. The Committee also approved the addition to the commentary on article 5 of the following alternative version of article 5 (3) for those countries wishing to delete article 14:

> "The term 'permanent establishment' also encompasses:
>
> "(a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
>
> "(b) The furnishing of services by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or connected project) within a contracting State for a period or periods aggregating more than 183 days within any 12-month period commencing or ending in the fiscal year concerned;
>
> "(c) For an individual, the performing of services in a contracting State by that individual, but only if the individual's stay in that State is for a period or periods aggregating more than 183 days within any 12-month period commencing or ending in the fiscal year concerned."

3. The Committee also agreed that the commentary on article 5 would reflect the fact that some countries did not agree with the view (as reflected in the new wording) that article 14 applies exclusively to individuals.

4. The present note discusses and makes recommendations for changes to the wording of article 14 and to the commentary for those countries that wish to retain article 14. In general, those countries take the view that article 14 applies to both individuals and entities. The present note does not address the broader issues concerning the appropriate treatment of income from services generally or the

[a] By Professor Brian Arnold.

treatment of fees for technical services under the United Nations Model. Those issues will be considered in a separate note ("the other note") that will be provided to the Subcommittee.[b] Nor does the present note repeat the comprehensive and thorough analysis of the interpretive issues arising under article 14 referred to in the paper of the Subcommittee on the Definition of Permanent Establishment entitled "Proposal for amendments to the United Nations Model Double Taxation Convention between Developed and Developing Countries: further issues relating to permanent establishment"[c] (hereinafter referred to as the Subcommittee paper).

5. The present note begins with a brief section setting out the assumptions or guiding principles on which the analysis contained in the note is based, followed by a brief description of the provisions of articles 7, 14 and 21 applicable to services. The scope of article 14 and the relationship between articles 7 and 14 are examined in detail to allow an assessment as to whether the changes to article 14 proposed in the present note would result in any significant change to the scope of source-country taxing rights. Several of the major interpretive issues arising under the existing wording of article 14 are then analysed. This part of the note is not intended to be exhaustive; only the major issues are addressed, and then only briefly. The note ends with recommendations for revising article 14 of the United Nations Model, primarily by moving article 5 (3) (b) into article 14. A draft of the revised article 14 is provided for discussion purposes. Possible revisions to the commentary on article 14 are also noted; at this stage, however, it would be premature to provide draft commentary.

## II. Assumptions or guiding principles

6. In my view, it is important to articulate clearly the assumptions or guiding principles on which the analysis contained in the present note is based. If those assumptions or principles are invalid, the analysis may be suspect and thus may need to be revised. The assumptions or guiding principles are as follows:

(a) There should be no significant change in the scope of source-country taxation. Consequently, any revisions to article 14 should not reduce source-country taxing rights with respect to income from services. The possible expansion of the scope of source-country taxation of income from services will be considered in the other note (on taxation of services) referred to above;

(b) The major interpretive difficulties under the existing article 14 should be eliminated or clarified;

(c) There should be consistent treatment of income from various types of services under the provisions of the United Nations Model unless there are convincing reasons for different treatment. Thus, dependent and independent services, and professional, technical, commercial and any other services, performed by individuals or entities should in principle be subject to the same tax treatment. In this context, "the same tax treatment" means that the same threshold for source-country taxation, the same rules for determining the amount of income subject to

[b] The note will be annexed to E/C.18/2010/CRP.8.

[c] E/C.18/2008/CRP.3, available at http://www.un.org/esa/ffd/tax/fourthsession/.

source-country taxation, and so forth, should be applied to all types of services.[d] However, it is assumed that the special treatment provided for certain types of services dealt with in specific provisions of the United Nations Model (such as entertainment and Government services) is justified;

(d) It is appropriate to offer countries some limited degree of choice with respect to the treatment of income from services.

## III. Overview of the provisions of the United Nations Model dealing with services

7. Several provisions of the model conventions of both the Organization for Economic Cooperation and Development (OECD) and the United Nations deal with various types of services. For the purposes of the present note, as mentioned above, the provisions of article 5 (6) (Insurance), article 8 (Shipping, inland waterways transport and air transport), article 16 (Directors' fees and remuneration of top-level managerial officials), article 17 (Artistes and sportspersons) and article 19 (Government service) of the United Nations Model are disregarded, because they deal with specialized types of services. For the same reason income from dependent personal services (employment) is not discussed.

### Article 7

8. Under article 7, income from services rendered by an enterprise resident in one contracting State in the other contracting State may be taxed in the other contracting State (the source country) only if the enterprise carries on business in the source country through a permanent establishment in the source country. If the enterprise carries on business through a permanent establishment in the source country, only the profits that are attributable to the permanent establishment or to other activities carried on in the source country that are the same as or similar to those carried on through the permanent establishment (a "limited force of attraction" rule) are taxable by the source-country. It is generally accepted that the source country tax under article 7 is limited to the net profits of the non-resident enterprise.

9. A permanent establishment is defined in article 5 to mean a fixed place of business through which the business of an enterprise is wholly or partly carried on. Also, a dependent agent is deemed to be a permanent establishment of a non-resident enterprise if the agent has and habitually exercises an authority to conclude contracts on behalf of the non-resident enterprise. The term "permanent establishment" also encompasses a building site, a construction, assembly or installation project or supervisory activities in connection with such a site or project if the site, project or activities last more than 183 days (currently six months). Construction and related services performed by a non-resident in the source country will be taxable by the source country only under these conditions. More generally, the term "permanent establishment" also encompasses the furnishing of services by a non-resident if the activities continue for more than 183 days (currently six months) and if they take place with respect to the same or a connected project.

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[d] It must be recognized that consistency in the treatment of income from services under the United Nations Model is difficult to achieve, given that some countries wish to delete article 14, while other countries wish to retain it.

10. It is unclear whether article 5 (3) (a) is a deeming provision or whether it simply prescribes an additional condition (a six-month time requirement) for a construction site to constitute a permanent establishment. Under the OECD Model, it is reasonably clear that article 5 (3), dealing with construction sites, is an additional condition, not a deeming provision. In other words, in order to constitute a permanent establishment, a construction site must meet the requirements of article 5 (1) and must also last for at least 12 months. With respect to the United Nations Model, this interpretation is not as clear. Article 5 (3) (b) is clearly a deeming provision, because otherwise it would be meaningless (it would apply only to services provided through a fixed place for a continuous period of more than 183 days). It represents an alternative to article 5 (1), not an additional requirement. If this is correct, then it is arguable that article 5 (3) (a) is also a deeming provision, unlike article 5 (3) of the OECD Model.[e] This issue should be clarified in the commentary.[f]

**Article 14**

11. Under article 14, income from professional services or other independent activities derived by a resident of one State in another State is subject to taxation by the other State in the following two circumstances:

(a) The resident has a fixed base in the other State that is regularly available to the resident for the purpose of performing the activities. In this case, which is similar to those dealt with by article 7, only the income attributable to the fixed base is taxable by the source country;

(b) The resident's stay in the source country lasts for 183 days or longer in the aggregate in any 12-month period. In this case, only the income from activities performed in the source country are taxable by the source country.

**Article 21**

12. Article 21 gives a source country the authority to tax items of income not dealt with in other articles of the treaty if such items of income have their source or arise in the source country. Consequently, if income from services is not subject to taxation by a source country under article 7 or article 14 for any reason, the income is arguably subject to tax under article 21. This result must be contrasted with the result under article 21 of the OECD Model, which gives the right to tax other income exclusively to the residence country.

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[e] Arguably, it is questionable whether article 5 (3) (a) is a deeming provision. For example, under article 5 (1), a fixed place of business must have geographical and commercial coherence. Thus, a business project that is carried on at different places is carried on through a permanent establishment only if the business is carried on at each place for at least six months. If article 5 (3) (a) is a deeming provision, then a construction project that is carried on in different places for more than six months would be deemed to be a permanent establishment, although it does not meet the requirements of article 5 (1).

[f] If article 5 (3) (b) were moved to article 14, as recommended in the present note, the problem would be largely resolved if not eliminated. There would be no argument that the requirements of article 5 (1) must be met in order for income from services to be taxed under article 14. The issue of whether article 5 (3) (a) is a deeming provision would remain; however, unaccompanied by article 5 (3) (b), it would be similar to article 5 (3) of the OECD Model.

13. The meaning of the phrase "not dealt with" is uncertain. One interpretation is that an item of income is not dealt with in an article unless it is subject to tax under that article. The other interpretation is that an item of income is dealt with in an article if it is income of the same nature as that of the income dealt with in the article. Under this interpretation, any items of business income not taxable under article 7 would nevertheless be considered to be dealt with in article 7, so that article 21, which would otherwise allow the source country to tax such income, would not apply.

14. In my view, it is inappropriate for article 21 to apply to income from services. Under articles 7 and 14, income from services is taxable only if a non-resident has a substantial presence in the source country. Article 21 should not allow source-country taxation simply if the income is sourced or arises in the country. Although article 21 is beyond the scope of the present note, it may be worthwhile to add a brief statement to the commentary on article 21 to clarify this issue.

**The scope of article 14**

15. The scope of application of article 14 can be seen from the brief description of the provision given above. It is important to precisely delimit that scope in order to ensure that any changes made to the wording of article 14 do not significantly reduce or expand source-country taxing rights. It is also important to identify any overlap or inconsistency between the provisions of articles 7 and those of article 14 with respect to income from services.[8] Not surprisingly, the major issues involved in determining the scope of application of article 14 are also some of the major interpretive issues that are discussed in more detail below.

16. In basic structural terms, the scope of article 14 can be determined by reference to the following factors:

(a) *The persons covered*. By its terms, article 14 applies to income from certain services derived by "a resident of a contracting State". Under article 4, "a resident of a contracting State" is defined as "any person" who is liable to tax under the laws of the State by reason of certain criteria. Under article 3 (1) (a), "a person" is broadly defined to include "an individual, a company and any body of persons". On the basis of those provisions, it seems clear that article 14 applies to income from services derived by both entities and individuals. However, this issue is not clear, for four reasons. First, the heading of article 14 is "Independent personal services". The word "personal" suggests that the article is restricted to services rendered by natural persons. In this regard, article 14 is a companion to article 15, which applies to dependent personal services. The words "he" and "his" in article 14, point to the same conclusion. Secondly, under the laws of some countries, professional and independent services can be performed only by individuals. Thirdly, paragraph 9 of the commentary on article 14 indicates that payments to an enterprise in respect of services provided by its employees or other personnel are

[8] Overlap between the provisions of article 7 and those of article 14 will create no difficulties as long as the tax consequences under both articles are the same. If the tax consequences under the two articles differ, it would be necessary to determine which article would apply in any particular situation. Although it is possible to attempt to make the tax consequences under articles 7 and 14 identical, it is impossible to ensure that, in the future, taxpayers, tax administrations and courts will not take the position that they differ. For this reason, it is preferable, in my view, to eliminate the possibility of overlap between the two articles.

subject to article 7. Fourthly, it is unclear how article 14 (1) (b) applies to entities. *The revised wording of article 14 as proposed below in the present note clarifies that article 14 applies to services rendered by entities*;

(b) *The types of income or services covered*. Article 14 applies to "professional services and other activities of an independent character". Professional services are defined inclusively and broadly in article 14 (2), indicating that article 14 is not limited to professional activities in a narrow traditional sense. Again, article 14 should probably be seen as a companion to article 15. The latter applies to employment or dependent personal services; the former applies to services performed by independent contractors. On the other hand, the commentary (para. 10) indicates that article 14 does not apply to industrial and commercial activities. There is no convincing (reason based on either the literal wording of article 14 or policy considerations) to restrict article 14 to professional services, although some countries apparently do so. *The revised wording of article 14 as proposed below in the present note clarifies that article 14 applies generally to all types of services*;

(c) *The conditions that must be satisfied in order for the source country to be entitled to tax income from services*. A source country is entitled to tax income from services under article 14 only if the taxpayer has a fixed base in the source country that is regularly available to him or her for the purpose of performing the services or if the taxpayer stays in the source country for 183 days or more. The commentary suggests that the meaning of the term "fixed base" in article 14 is the same as that of the term "fixed place of business" in the definition of "permanent establishment" in article 5 (1), despite the fact that the two terms are clearly different. Moreover, under article 14, a fixed base must be regularly available to the taxpayer, whereas under article 5 (1) a taxpayer's business must be carried on through the fixed place of business. It is unclear whether those two requirements are the same.

## IV. A comparison of the scope of articles 7 and 14

17. The analysis set out below compares the scope of article 14, as described above, with the scope of article 7 in respect of income from services. This comparison is made on the basis of the same three factors referred to above to determine the scope of article 14:

(a) *The persons covered*. Article 7 applies to the profits of "an enterprise of a contracting State", which is defined in article 3 (1) (c) as an enterprise carried on by "a resident of a contracting State", which in turn is defined in article 4 as "any person" who is liable to tax under the laws of the country on the basis of certain factors. A person is defined broadly in article 3 (1) (a) to include both individuals and legal entities. Consequently, in terms of persons covered, the scope of article 7 is at least as broad as that of article 14, on the assumption that article 14 applies to entities, and broader than that of article 14, on the assumption that article 14 is restricted to individuals. Therefore, article 14 should be revised to clarify that it applies to both individuals and entities. Issues also arise concerning the treatment of partnerships under article 14. These issues are discussed paragraphs 18 and 19 of the Subcommittee paper;

(b) *The types of income or services covered*. Article 7 applies to profits from the carrying on of a business. Neither the term "business" nor the term "profits" is

defined in the treaty. As a result, by virtue of article 3 (2), those terms have the meaning that they have under the law of the State applying the treaty unless the context requires otherwise. Accordingly, if professional or other services are considered not to constitute the carrying on of a business under the domestic law of a State (which appears to be the case in some countries), article 7 would not apply unless the tax authorities or the courts conclude that the context of the treaty requires that the term "business" for the purposes of the treaty should have a broader meaning than under domestic law. In contrast, article 14 applies only to a specific type of business income, namely, income from professional and other independent services. For those countries that consider professional and other independent services to be a business under domestic law, there will be considerable overlap between articles 7 and 14. However, in any case where both provisions apply, article 7 (6) gives priority to article 14;

(c) *The conditions that must be satisfied in order for the source country to be able to tax income from services.* Under article 7, the source country is entitled to tax income from services if the non-resident taxpayer carries on business through a permanent establishment in the source country. A permanent establishment is defined in article 5. In order to compare the scope of application of articles 7 and 14 with respect to services, it is necessary to make a detailed comparison of: (i) the concepts of a fixed place of business and a fixed base; and (ii) the provisions of article 5 (3) (b) and article 14 (1) (b). Article 5 deals with insurance, construction, assembly, installation and related supervisory services. Article 14 does not cover these services unless they are considered to be professional services or services of an independent nature. In any cases in which such services are dealt with by both article 7 and article 14, article 14 takes precedence as a result of article 7 (6). In any comparison of the concept of a fixed base and a permanent establishment, the most important point is that the former is not defined at all, whereas the latter is defined extensively in article 5. Thus, there is inevitably more uncertainty concerning the meaning of a fixed base then there is concerning the meaning of a permanent establishment;

(i) *Comparison of "fixed base" and "fixed place of business".* The commentary on article 14, which is borrowed from the former commentary on article 14 of the OECD Model, states that articles 7 and 14 are based on the same principles (para. 10 of the commentary on article 14). This statement has led some commentators to suggest that the term "fixed base" has the same meaning as that of a permanent establishment in article 5. Some courts have reached the same conclusion.[b] Furthermore, the OECD commentary (para. 11 of the commentary on article 5) indicates that no differences in meaning between "fixed base" and "permanent establishment" were intended. Although there may be some subtle differences between the concept of a fixed base and that of a permanent establishment, it seems unlikely that those differences have any serious practical significance. The Subcommittee came to the same conclusion (see Subcommittee paper, paras. 29-38 and annex 5).[c] The concept of a fixed base could reasonably be interpreted to be the equivalent of a fixed place of business as referred to in article 5 (1). On the basis of this equivalence, it might be possible to read the exemptions for preparatory and

[b] *Dudney v. The Queen* [2002], 2 CTC 56 (FCA); Supreme Court of the Netherlands, 25 March 1992, BNB 1992/245; and Supreme Court of the Netherlands, 24 June 1981, BNB 1981/236.

[c] The Committee as a whole did not agree on this point.

auxiliary activities in article 5 (4) into article 14. It seems more difficult to incorporate the agency permanent establishment rules in article 5 (5) and (7) into article 14; however, those rules have less significance for most service businesses than for other types of businesses. Article 5 (1) defines a fixed place of business as a permanent establishment if the business of the enterprise is wholly or partly carried on through the fixed place. In contrast, article 14 requires that the fixed base be regularly available to the taxpayer. It is unclear whether there is any significant difference between those requirements.[j] The commentary on article 5 (1) indicates that a fixed place of business is a permanent establishment only if it is "at the disposal" of the taxpayer. This condition is similar, if not identical, to the condition that a fixed place be "regularly available" to the taxpayer. Even if there are differences between the concept of a fixed base and that of a fixed place of business, there is no justification for the term "fixed base" to be interpreted more broadly or more narrowly than the fixed-place-of-business aspect of the definition of a permanent establishment. Unless the distinction between "fixed base" and the fixed-place-of-business aspect of the definition of a permanent establishment is eliminated, the risk of inappropriate results will remain;[k]

(ii) *Comparison of articles 5 (3) (b) and 14 (1) (b)*. Article 14 (1) (b) applies if the non-resident service provider stays in the source country for 183 days or more in the aggregate in any 12-month period commencing or ending in the relevant fiscal period. The commentary on article 14 (para. 6) makes it clear that this provision is based on the taxpayer's physical presence in the source country, which presumably should be applied on the same basis as the similar test in article 15 (2). Paragraph 1 of the commentary on article 15 clarifies that all days of presence are counted for this purpose irrespective of whether the taxpayer is working. In contrast, article 5 (3) (b) is a much narrower provision. It applies only if the service activities (working days) continue for more than 183 days (currently 6 months) in any 12-month period; moreover, the services must be provided for the same or a connected project. Therefore, some situations covered by article 14 (1) (b) are not covered by article 7. For this reason, the alternative version of article 5 will include a provision similar to article 14 (1) (b). However, the same or connected project requirement will be retained in article 5 (3) (b). In addition, there is a difference between the thresholds for source-country taxation under the alternative version of article 5 and article 14. Although there is a significant difference between the threshold under article 5 (3) (b) (days of service for the same or a connected project) and that under article 14 (1) (b) (days of presence) of the current United Nations Model, that difference would be reduced or eliminated under the amended wording of article 5. The addition of article 5 (3) (c) effectively moves existing article 14 (1) (b) into article 5. The only difference between article 14 (1) (b) and the new article 5 (3) (c) is that the new article 5 (3) (c) applies only to

[j] Any uncertainty in this regard would be eliminated if article 14 is deleted.

[k] For example, there is no time requirement for a fixed base specified in article 14 or the commentary, whereas a minimum period of six months is specified for permanent establishments in paragraph 6 of the commentary on article 5 of the OECD Model. Therefore, it is possible for the phrase "regularly available" to be interpreted to mean a period of more or less than the six-month period generally applicable in respect of fixed-place-of-business permanent establishments.

individuals, whereas, according to some countries, article 14 (1) (b) applies to both individuals and entities. It is unclear whether this is a serious practical problem. For countries that apply article 14 only to individuals or professional services, the deletion of article 14 is unlikely to result in any significant reduction in source-country taxing rights. The jurisdiction of such countries to tax may actually expand, because professional services rendered by entities and independent services rendered by individuals would be taxable under article 7 on the basis of the new article 5 (3) (c). On the other hand, the taxing rights of any countries that apply article 14 to entities and to independent services, may be reduced if article 14 is deleted. Under article 14 (1) (b), the source country is entitled to tax if the non-resident is present in the source country for 183 days or more. However, if article 14 is deleted, the source country would be entitled to tax entities only if the non-resident entity's employees or other personnel work in the source country for more than 183 days (currently six months) on the same or a connected project. Because of the wording of article 14 (1) (b), its application to entities is unclear. Apparently, there are more than 20 countries that take the position that article 14 applies to entities. The wording of article 14 should be revised to clarify that it applies to entities. There is a broader question concerning the appropriateness of source countries' taxing income from services derived by non-residents under the conditions specified in article 14 (1) (b), those specified in article 5 (3) (b) or other conditions. This question is considered in the note on services.

## V. The major interpretive issues under article 14

### Does article 14 apply to entities?

18. It is unclear whether article 14, as currently worded, applies only to individuals or to both individuals and entities. Professional and other independent services can be performed by both individuals and entities under the laws of some countries. There is no justification for applying different rules under the United Nations Model treaty to individuals and entities performing the same services. Article 14 should be amended to clarify that it applies to entities. Such an amendment would increase the overlap between articles 7 and 14; however, by virtue of article 7 (6), article 14 would take precedence in any such case. Such an amendment would also raise the question of the application of the physical-presence threshold under article 14 (1) (b) to entities and the relationship between article 5 (3) (b) and article 14 (1) (b). This issue is discussed below.

### Services covered

19. By its terms, article 14 applies only to professional and other services of an independent nature. Income from other services is dealt with under article 7. As a result, it is necessary to determine the nature of the services performed by a taxpayer in order to apply article 14. For example, it is unclear whether article 14 applies to fees derived for technical assistance. As noted in the section of the present note setting out assumptions and general principles, there is no relevant distinction between professional and other services in the modern economy. Income from services is simply a particular type of business income. In general, income from services should be subject to the same rules under the United Nations Model as other types of business income unless there are good reasons for different treatment.

This argument supports subjecting all services to the same rules to the extent possible while retaining article 14. Thus, article 14 should be revised to make it applicable to all services other than those that are performed through a fixed place of business and, as a result, are subject to article 7. This alternative would involve deleting article 5 (3) (b) and adding a similar provision to article 14. There would still be borderline issues between articles 7 and 14. However, dealing with all services other than those performed through a permanent establishment would represent a sensible allocation for the taxation of services between articles 7 and 14 and would clarify the source-country taxation of income from such services, as distinguished from the taxation of business income generally.

**Fixed base**

20. The use of a fixed-place threshold for the source-country taxation of professional services under article 14 causes unnecessary uncertainty. As discussed above, there is considerable debate as to whether a fixed base is the same as or different from a fixed place of business. Irrespective of whether the concepts are the same or different, the use of two terms requires that other provisions of the Model refer to both terms. In the absence of reference to both terms, uncertainty is created as to whether the particular provision applies to both, or only to the term mentioned. For example, the protection against discrimination in article 24 (3) applies literally only to permanent establishments; it should apply equally to non-residents providing services through a fixed base. However, the absence of any reference to a fixed base in article 24 (3), when contrasted with several other provisions that refer to both permanent establishments and fixed bases, may lead to an interpretation of article 24 (3) that restricts it to permanent establishments.

21. Article 14 would be clarified if it were revised to apply only to income from services performed by a non-resident in circumstances where the non-resident does not have a fixed place of business in the source country. This is the key issue to be considered in deciding on the scope of article 14. In the modern economy, a resident of one country can render services in another country without having any fixed place of business there. The critical question is under what conditions source countries should be entitled to tax such income from services. Given the current provisions of article 5 and article 14 (and on the alternative services permanent establishment provision that was recently added to the commentary on article 5 of the OECD Model), it seems that there is widespread agreement that a source country is entitled to tax income from services where the non-resident service provider is present in the source country or is performing services in the source country for a significant period (more than 183 days) during a year.

**Time thresholds**

22. The time thresholds in articles 5 (3) (b) and 14 (1) (b) are inconsistent for no apparent reason. Article 5 refers to a six-month period, while article 14 refers to a period of 183 days. This difference will be eliminated, because the new version of article 5 (3) (b) refers to 183 days. There is a further inconsistency, in that article 5 (3) (b) refers to a period or periods aggregating more than 183 days, whereas article 14 (1) (b) refers to a period or periods amounting to or exceeding in the aggregate 183 days. These time limits should be consistent.

**Computational rules**

23. Article 14 does not provide any rules for the computation of the income attributable to a fixed base or derived from activities performed in the source country. The commentary on article 14 (para. 10) indicates that the computational rules in article 7 should apply for the purposes of article 14. However, this is not completely clear. Some countries may take the position that income from services under article 14 may be taxed by way of withholding on a gross basis without allowing any deductions. If article 14 is deleted and the alternative version of article 5 is adopted, the computation of income from services previously dealt with under article 14 would be subject to the rules of article 7. In my view, this would be the appropriate result. Therefore, if article 14 is retained, it should be amended to clarify that any income from services taxable by a source country should be determined in accordance with the same basic rules as those applicable under article 7. Thus, if a source country wishes to use withholding as a collection device for non-resident service providers, it must allow them to file a return on a net basis and to claim a refund for any excessive withholding tax.[1]

24. The application to article 14 of the new rules for the computation of the profits attributable to a permanent establishment under the proposed article 7 and commentary of the OECD Model is beyond the scope of the present note.

## VI. Recommendations

25. On the basis of the foregoing analysis, there are two options for improving article 14. The first is to leave the basic scope of article 14 unchanged and to try to clarify the interpretive issues. At the very least, this would involve defining the term "fixed base" and clarifying the application of article 14 to entities. In my opinion, this option would be unlikely to produce satisfactory results; it is not discussed further in the present note. The second option is to revise article 14 of the United Nations Model to deal with income from services generally, other than income from services earned through a fixed place of business, construction and insurance services. In particular, article 5 (3) (b) should be deleted from article 5 and incorporated into article 14 with certain modifications.

26. Currently, certain income from services is dealt with under article 7 and certain other income from services is dealt with under article 14. Unlike other articles, such as articles 17 and 19, which deal with special types of services, the provisions of both article 7 and article 14 can be viewed as general provisions, especially if article 14 is considered to apply to all independent services, not only professional services, and to services provided by entities as well as by individuals. The current United Nations Model is confusing in this regard because there is considerable overlap between the two articles and they differ significantly.

27. It would be preferable if the United Nations Model had one article that dealt with services generally and other articles that dealt only with special types of services. The deletion of article 14 would achieve that result. Some countries, however, consider that the alternative version of article 5 (3) and the deletion of article 14 are not successful in fully incorporating article 14 into article 5. For that

[1] If article 24 (3) applies to article 14, a source country might be precluded from imposing a withholding tax on non-resident service providers.

reason, they wish to retain article 14. For those countries, the goal should be to achieve the same result — one article that deals with services generally and other articles that deal with special types of services — through amendments to article 14.

28. Under this approach, article 7 would deal with special or limited types of income from services, namely, construction, insurance[m] and services performed through a fixed place of business. Article 14 would be revised to deal with income from services more generally. More specifically, article 5 (3) (b) would be moved from article 5 to article 14; the fixed-base concept would be eliminated, and the scope of article 14 would be revised to cover all income from services and all taxpayers. This approach is attractive, because it would create parallel treatment for those countries that delete article 14 and those countries that retain article 14.

29. Under the approach set out above:

(a) **Article 5 (3) (b) should be deleted. The commentary on article 5 would contain the alternative wording of article 5 (3) approved by the Committee of Experts for those countries wishing to delete article 14;**

(b) **Article 14 would be revised as follows:**

**Article 14**

**Income from Services**

1. **Subject to the provisions of articles 15, 16, 18 and 19, income derived by an enterprise of a contracting State in respect of services shall be taxable only in that State except in the following circumstances, when the income may also be taxed in the other contracting State:**

(a) **The enterprise furnishes services [including consultancy services], through one or more individuals engaged by the enterprise for such purpose, but only if activities of that nature continue within the other contracting State for a period or periods aggregating 183 days or more[n] within any 12-month period commencing or ending in the fiscal period concerned; or**

(b) **If the enterprise is an individual who furnishes services in the other contracting State, but only if the individual's stay in that State is for a period or periods aggregating 183 days or more[o] in any 12-month period commencing or ending in the fiscal year concerned.**

2. **If an enterprise of a contracting State furnishes services in the other contracting State in the circumstances described in paragraph 1 (a) or (b), only the income derived from the services performed in the other State may be taxed in the other State.**

30. Several other consequential amendments to other articles would be necessary. The references to the term "fixed base" in other articles should be deleted.

31. In any situation in which both article 7 and article 14 apply (for example, construction services), article 14 would prevail pursuant to article 7 (6). This seems

[m] Consideration should be given to moving article 5 (6) to article 14.

[n] Alternatively, the time limit could be worded as "more than 183 days".

[o] Alternatively, the time limit could be worded as "more than 183 days".

to be an appropriate result, especially in the light of the fact that the alternative services permanent establishment rule in the commentary on article 5 of the OECD Model prevails over article 5 (1), (2) and (3). It should be noted that under the proposed version of article 14 the overlap between articles 7 and 14 would be limited. The extent of the overlap could be reduced further if article 5 (6), dealing with insurance services, were deleted from article 5 and added to article 14.

32. The proposed article 14 contains no exception for preparatory or auxiliary services because, in my view, such an exception is unnecessary and undesirable.[p] The Subcommittee on the Definition of Permanent Establishment concluded that the exception for preparatory or auxiliary activities would be relevant for services only in rare cases and suggested that some countries might wish to exclude the application of the exception to services (see Subcommittee paper, paras. 40-49).

33. The same or connected project requirement in article 5 (3) (b) has not been included in the revised version of article 14 set out above. As discussed more fully in the note on services, that requirement is an inappropriate restriction on the taxing rights of source countries with respect to income from services. The note on services recommends that the requirement that services be performed in connection with the same or a connected project be deleted from article 5 (3) (b). If that recommendation is accepted, the conditions for the taxation of income from services under article 7 and article 14 would be consistent in that regard.

**Additional amendments to article 14**

*Rules for the determination of income from services subject to tax*

34. The commentary on article 14 (para. 10) provides that, because the principles upon which articles 7 and 14 are based are the same, the rules for the allocation of profits between a head office and a permanent establishment can be applied to services performed from a fixed base. That commentary provides further that expenses incurred for the purposes of the fixed base should be deductible in computing the income attributable to the fixed base in accordance with article 7 (3).

35. For countries that delete article 14 and adopt the alternative version of article 5 (3), the result obviously is that the rules in article 7 apply and require income from services taxable under article 7 to be taxed on a net basis. Moreover, the provisions of article 24 (3) would apply, precluding a source country from taxing income from services derived by non-residents in a discriminatory fashion in comparison with residents. The Subcommittee concluded that this would be the appropriate result (see Subcommittee papers, para. 57).

36. If, on the other hand, article 14 is retained and revised as recommended in the present note, the concept of a fixed base would be eliminated. Therefore, the issue is whether rules are necessary, in article 14 itself or in the commentary, concerning the determination of the income subject to source-country tax and, in particular, the deduction of expenses in computing such income. In the absence of such rules, it would continue to be uncertain whether income under article 14 was taxable on a net or a gross basis. Other provisions of the United Nations Model that refer to "income", such as those of articles 6 and 17, allow for source-country taxation on a

[p] The OECD alternative services provision regarding permanent establishment contains the exception for preparatory and auxiliary activities.

gross basis. On the other hand, those articles can be seen as exceptional. Taxpayers who perform independent services often incur significant expenses in doing so. Moreover, expenses would be deductible under article 7 if the services were performed through a permanent establishment. Therefore, source countries should be required to tax income from services under the revised article 14 on a net basis. This result can be achieved by adding a provision to article 14 itself, by amending the commentary on article 14 to clarify that expenses must be deductible, or by revising article 24 (3) to make it applicable to a resident of a contracting State deriving income from services performed in the other contracting State that are taxable under article 14.

37. If Article 24 (3) is revised to apply to non-resident service providers subject to source-country tax under article 14, source countries would be precluded from imposing final gross-based withholding taxes on non-resident service providers unless resident service providers were subject to similar taxes. However, article 24 (3) prevents a source country from taxing non-residents less favourably than residents; it does not prevent non-residents from being taxed differently from residents to take account of their different circumstances. Therefore, source countries would be able to require interim withholding on fees paid to non-resident service providers as long as those non-residents were entitled to file tax returns on a net basis and to claim a refund for any excessive withholding.

38. If some source countries wish to tax non-resident service providers on a gross basis (perhaps because they lack the administrative resources to process and verify returns on a net basis), the United Nations Model could authorize them to do so. It can be argued that income from services derived by non-residents is no different from income derived from immovable property situated in a country or income derived by non-resident entertainers and athletes. On the other hand, it can be argued that income from services generally is more like income from business, which is taxable on a net basis under article 7. One possible solution would be to allow source countries to tax income from services on a gross basis but to limit the rate of tax as is done for dividends, interest and royalties under articles 10, 11 and 12. In other words, under article 14 of the United Nations Model, source countries would have the choice of taxing income from services derived by non-residents on a net basis with no limitation on the rate of source-country tax, or on a gross basis with a limitation on the rate of source-country tax (say, for example, 20 per cent).

*Non-discrimination protection for non-resident service providers*

39. As discussed above, if article 14 is retained, article 24 should be amended to provide protection against discrimination for non-resident service providers on terms similar to the protection afforded by article 24 (3) for non-residents carrying on business through a permanent establishment.

*The OECD alternative permanent establishment rule for services*

40. In 2008, the commentary on article 5 of the OECD Model was revised to add an alternative provision deeming a permanent establishment to exist in certain circumstances where an enterprise of one contracting country performs services in the other contracting country. The OECD alternative provision clearly draws on article 5 (3) (b) and article 14 (1) (b) of the United Nations Model. However, the OECD alternative provision also makes a number of improvements on the

provisions of the United Nations Model. Those improvements do not result in any significant reduction in source-country taxing rights. As a result, some of those improvements should be incorporated into article 14 of the United Nations Model or into the alternative wording of article 5 (3), for those countries that delete article 14. The improvements that should be incorporated into the United Nations Model are described briefly below:

(a) The OECD alternative provision deals more effectively than the provisions of the United Nations Model with situations in which individuals provide services on behalf of entities that they own. For example, under article 14 of the United Nations Model (including the draft revised article 14 in the present note), income from services provided by an individual who stays in the source country for more than 183 days is subject to source-country tax. However, such an individual may be able to avoid source-country tax by performing the services as an employee of a corporation all of whose shares are owned by the employee, or as a partner in a partnership;

(b) The OECD alternative provision clarifies that if an enterprise uses independent contractors to perform services on its behalf, those individuals will not be taken into account unless the enterprise directs, supervises or controls the activities of those individuals;

(c) The commentary relating to the OECD alternative provision contains several useful explanations that should be added to the commentary on article 14 or on article 5 (3), if article 14 is deleted. For example, the OECD commentary clarifies the relationship between the construction site permanent establishment rule and the alternative services permanent establishment rule, explicitly states that the provision applies only to services rendered to other persons (not services performed for the enterprise itself), and provides helpful examples to illustrate the application of the provision.